No. 87-984

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1987

SHELL OIL COMPANY,
Appellant,

v.

THE IOWA DEPARTMENT OF REVENUE,
Appellee.

On Appeal from the Supreme Court of Iowa

BRIEF FOR THE APPELLEE

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QUESTION PRESENTED

Whether the Outer Continental Shelf Lands Act Precludes the State of Iowa From Imposing a Tax Upon That Portion of a Unitary Net Income Base Which is Reasonably Attributable to the Taxpayer's Income Producing Activities in Iowa.

PARTIES TO PROCEEDINGS BELOW

The parties before the Supreme Court of Iowa with respect to the question presented were Shell Oil Company and the Iowa Department of Revenue.

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BRIEF FOR THE APPELLEE

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OPINIONS BELOW

The opinion of the Supreme Court of Iowa (J.S. App. 1a-14a) is reported at 414 N.W.2d 113. The opinion of the District Court of Polk County (J.S. App. 15a-35a) is not reported.

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STATEMENT OF THE CASE

Shell Oil Company (Shell) is engaged in business in all fifty States and in the District of Columbia. (J.A. 13). In the years 1975 through 1980, Shell's principal business activities in the United States were the exploration for, and development, production, transportation, purchase, and marketing of crude oil and natural gas, and the purchase, manufacture, and marketing of oil and chemical products. (J.A. 13-14). The parties agree that Shell's operations, including those in Iowa and in the outer Continental Shelf (OCS), constitute a single unitary business similar to those in *Exxon Corp. v. Wisconsin Department of Revenue,* 447 U.S. 207 (1980). (J.A. 20).

During the years 1975 through 1980, Shell conducted most of its business activities between two internal operating divisions, known as the Exploration and Production (E & P) Organization and the Products Organization. (J.A. 14). The E & P Organization located, acquired, and produced crude oil and natural gas. (J.A. 14). The Products Organization purchased, transported, and marketed crude oil and natural gas liquids, and manufactured and marketed petroleum and chemical products. (J.A. 14).

Shell's E & P Organization transferred most, but not all, of Shell's OCS crude oil production to the Products Organization in the continental United States. (J.A. 15, 29). This crude oil was either exchanged with other oil companies or was first refined by Shell and then sold or exchanged. (J.A. 29). If the OCS crude oil was refined by Shell, it was commingled with crude oil produced or purchased by Shell from other non-OCS sources so that

the ultimate source of the oil in Shell refined products is indeterminable. (J.A. 19).

Shell's intracompany transfers between its E & P Organization and its Products Organization were internally recorded by Shell as "sales," but no money or other consideration was ever paid. (J.A. 15-16). Shell was a "net purchaser" of crude oil, that is, Shell's total crude oil production from OCS and non-OCS sources was inadequate for Shell's requirements so that Shell purchased the balance of its crude oil needs from other sources, including OCS producers, domestic producers, and foreign producers[1]. (J.A. 16).

Shell's natural gas production in the OCS was purchased by gas transmission companies at the OCS wellhead. (J.A. 34). In contrast to Shell's intracompany crude oil transfers, these third party gas sales in the OCS were for cash. (J.A. 34).

The portion of Shell's unitary business activities in Iowa involved the sale of oil and chemical products which Shell had refined and manufactured outside of Iowa. (J.A. 19). Shell sold crude oil based products in Iowa which it had manufactured from commingled OCS and non-OCS oil. (J.A. 19). The circumstances and detail of Shell's Iowa activities associated with these third party sales are not in the record.

Iowa imposes an income tax upon corporations doing business in Iowa. (Iowa Code § 422.33(2); J.S. App. 95a-96a). The unitary net income of a corporate taxpayer is

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[1]The record does not indicate the amounts of these crude oil purchases from each source.

determined with respect to the corporation's federal taxable income, with some adjustments not relevant to this case. (Iowa Code § 422.35; J.S. App. 96a). The unitary operating net income of a corporation, such as Shell, which does business within and without Iowa is apportioned by a single sales factor formula to impose the tax "only on the portion of the net income reasonably attributable to the trade or business within the state" of Iowa.[2] (J.S. App. 96a).

Iowa's method of apportionment of a single corporation's unitary net income was upheld by this Court, with respect to constitutional attack upon Due Process and Commerce Clause grounds, in *Moorman Manufacturing Company v. Bair*, 437 U.S. 267 (1978). The Iowa Supreme Court has interpreted the Iowa unitary business/formula apportionment method for determining Iowa taxable income as one which "manifests an intent on the part of the legislature to impose a tax on all foreign corporate activities in Iowa that can reasonably be said to produce income." *American Home Products Corporation v. Iowa State Board of Tax Review*, 302 N.W.2d 140, 144 (Iowa 1981); *Internorth, Inc. v. Iowa State Board of Tax Review*, 333 N.W.2d 471, 475 (Iowa 1983).

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[2]Iowa does not impose its tax upon a combined reporting basis upheld by this Court in *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983). None of Shell's subsidiaries or affiliates was included in the unitary net income base or in the formula. (J.S. App. 97a-103a). Iowa does include within the scope of its unitary net income base business investment income. *Mobil Oil Corp. v. Vermont Comm'r of Taxes*, 445 U.S. 425 (1980). However, that type of unitary net income is not a subject of this case. Therefore, this case only involves Shell's unitary operating net income earned as a single corporation.

Shell has conceded that the Iowa unitary business/formula apportionment method attributes a reasonable portion of its net income to Iowa as a result of its Iowa activities. (J.S. 7, 12; Shell Brief at 12). There is nothing in the record in this case to support any assumption that the Iowa tax exceeded Shell's profits associated with its Iowa activities.

For 1975 through 1980, Shell filed Iowa income tax returns in which it self-determined its Iowa taxable income under three different methods. (MDA. App. Exhibit N, par. 7). First, for 1975 and 1976, Shell subjected to apportionment to Iowa its total unitary net income by applying a three factor property—payroll—sales formula. Second, for 1977, 1978, and 1979, Shell subjected to apportionment to Iowa part of its unitary net income, after deducting from the unitary net income base a figure purporting to be its "income earned" in the OCS, by applying the Iowa single sales factor formula. Third, for 1980, Shell subjected to apportionment to Iowa its total unitary net income by applying the Iowa single sales factor formula. Of these three methods used by Shell, two did not involve any separate accounting calculation and deduction from the unitary net income base of a purported OCS net income figure.

The Iowa Department of Revenue audited Shell's Iowa income tax returns for 1975 through 1980 and assessed additional tax to Shell. The Revenue Department, in its audit and assessment, restored the purported OCS income figure to the unitary net income base for years 1977, 1978, and 1979. The Revenue Department disallowed the use by Shell of its three factor apportionment formula. The

Revenue Department's audit uniformly apportioned Shell's total unitary operating net income to Iowa by the Iowa sales formula, the numerator of which was Shell's Iowa sales and the denominator of which was Shell's sales everywhere, including in the OCS.

Shell protested the assessment in accordance with the administrative procedures provided by the Revenue Department. An administrative hearing was requested with respect to Shell's assertion that the assessment resulted in the taxation of Shell's income derived from the OCS and was in violation of the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. § 1331 *et seq.* (J.A. 48).

Shell's contention that the assessment violated the OCSLA was premised upon its calculation of its alleged OCS net income figure from its oil and gas extraction. In making this OCS calculation, Shell used the posted industry price (value of production) for that grade of oil which was transferred by Shell's E & P Organization to its Products Organization and which was ultimately exchanged or sold outside the OCS. (J.A. 30-31, 45). The calculation also included actual sales prices received from the gas transmission companies for sales of OCS gas in the OCS. (J.A. 34). These posted oil prices and Shell's receipts from gas sales were included by Shell in its determination of its OCS "revenues." (J.A. 36). Shell subtracted from these posted industry oil price "revenues" and from actual gas revenues the expenses which were incurred on and off the Shelf and which it deemed to be functionally related to its OCS production. (J.A. 29-30; MDA. App. Exhibit N, par. 3).

Iowa disputed Shell's calculations as reflecting Shell's OCS net income. (J.A. 29-30, Stip. pars. 22 and 23; MDA. App. Exhibit N, pars. 3-6, 7-10). Indeed, even under a separate accounting theory, Iowa may have been shortchanged by Shell's calculations. (MDA. App. Exhibit N, pars. 3 and 4).

Shell's calculation of its OCS net income figure was done by a separate accounting method that used a functional, not a geographic, approach. (MDA. App. Exhibit N, par. 3). This is obvious because not all expenses attributed by Shell to the OCS, in its separate accounting method, were actually incurred in the area of the OCS. (J.A. 38, lines 17 and 18; 40, lines 23, 24, 26 and 27; 41, line 29). Shell's separate accounting method failed to attribute a portion of its refining and sales expenses which, although incurred outside the OCS, would be functionally related to the OCS. (MDA. App. Exhibit N, pars. 3-4). Obviously, Shell's failure to attribute such refining and sales expenses to the OCS, under generally accepted accounting principles, augments Shell's OCS income figure and decreases the unitary net income base which Shell concedes is apportionable.

Even if Shell had attributed some refining and sales expenses to the OCS, Iowa's position was that the resulting computation would not prove that Iowa taxed any of Shell's OCS net income. (MDA. App. Exhibit N, par. 4). Generally accepted accounting principles are not designed

to ascertain the geographic source of income.[3] (MDA. App. Exhibit N, pars. 9-10).

At the administrative hearing, Shell's evidence basically consisted of its OCS separate accounting method and the attribution of the remainder of its income to Iowa by the Iowa unitary business/formula apportionment method.[4] Shell did not present any evidence with respect to the source of its Iowa profits nor did Shell present any evidence with respect to profits or losses of any other portion of its non-OCS business. Although the record does not reflect the amount of Shell's purchases from other OCS producers, Shell did not purport to exclude such purchases from its cost of goods sold in calculating its so-

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[3]Shell had alleged that its OCS separate accounting income figure was equivalent "of what Shell's net OCS income would be for federal income tax purposes if computed for that segment of Shell's business." (J.A. 29). This allegation was controverted by Iowa. (J.A. 30, 45; MDA. App. Exhibit N, pars. 5 and 6). No tribunal below found that Shell's allegation was true. The Internal Revenue Code does not impose federal income tax upon a mere segment of a corporation's companywide operating income.

[4]Shell had raised an alternative issue of whether the OCSLA required its total OCS "revenues," that is, gross receipts from sales of gas and the gross value of production of oil to be excluded from the unitary net income base without deduction therefrom of any OCS expenses. However, in light of this Court's decision in *First National Bank of Atlanta v. Bartow County Board of Tax Assessors*, 470 U.S. 583 (1985), Shell withdrew its claim for relief in paragraph 47(c) of the Stipulation (J.A. 48-49) in page 1 of its Reply Brief filed in the administrative proceeding. Thus, Shell does not apparently agree with the dissent in *Shell Oil Co. v. Department of Revenue*, 496 So.2d 789, 796 (Fla. 1986), appeal pending 86-1593, which stated that "[t]he proper amount to be excluded is the fair market value of the oil and gas at the wellhead." Shell's withdrawn claim is not an issue before this Court.

called non-OCS income to be apportioned.[5] Therefore, in determining its unitary net income base to be apportioned to Iowa, transactions involving OCS extracted minerals were not wholly ignored by Shell.

The administrative decision concluded that the assessment did not violate the OCSLA. (J.S. App. 74a; par. 17). Significantly, that decision contained a finding that Shell had failed to prove that the assessment taxed its OCS income. (J.S. App. 70a; par. 9).

Shell appealed the administrative decision to the Polk County District Court. The District Court held that the OCSLA prohibited State extraterritorial taxation into the OCS, but did not prohibit a tax "directly attributable to Shell's sales within the State of Iowa." (J.S. App. 33a). The Court found that Shell was not subjected to extraterritorial taxation into the area of the OCS. (J.S. App. 30a-33a).

Shell appealed the District Court's decision to the Iowa Supreme Court. The Iowa Supreme Court rejected Shell's claim that the OCSLA inherently required an exclusion of a separate accounting OCS net income figure from the unitary net income base. (J.S. App. 9a). The Court noted that "Shell has indicated no particular area of congressional policy in the management and control of the OCS lands which is frustrated by the State of Iowa applying a traditional measure of apportionment in order

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[5]For federal and Iowa income tax purposes, gross income is gross receipts less cost of goods sold. Treas. Reg. § 1.61-3(a). Obviously, if cost of goods sold decrease, gross income is augmented. Iowa believes that both sales and purchases of OCS minerals can be reflected in the unitary net income base.

to obtain a valid local nexus for taxation purposes."[6] (J.S. App. 9a). The Court viewed the state tax restrictions in the OCSLA "as a limitation on the authority of states adjacent to the OCS lands to extend legislative jurisdiction to the OCS." (J.S. App. 10a). The Court noted that the inclusion of OCS activities in the unitary business/formula apportionment method "apparently aids in obtaining an accurate measure of the tax to be imposed as a result of Shell's Iowa activities," and that there was an absence in the language or legislative history of the OCSLA that Congress intended to modify the State's ability to tax income attributable to the taxpayer's activities in the taxing State. (J.S. App. 13a). Accordingly, the District Court's decision on the OCS issue was affirmed.

Shell, in its appeal to this Court, has limited its challenge upon OCSLA grounds only to the makeup of the unitary net income base. Even if the Iowa unitary business/formula apportionment method, as applied to Shell, operated to only tax Shell's profits earned in Iowa or even understated Shell's Iowa profits, nevertheless, Shell's position is that it is entitled under the OCSLA to exclude from the unitary net income base a separate accounting OCS net income figure.

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[6]The United States, in its Briefs filed in this case and in the pending Florida case, agrees.

SUMMARY OF ARGUMENT

The Iowa unitary business/formula apportionment method is used to determine the net income attributable to the taxpayer's income producing activities in Iowa. It is used because of the inherent inability of separate accounting to precisely source unitary income to any geographical area. In view of the nature of a unitary business, its net income is not derived from a single "source."

In this case, Shell seeks to exclude a separate accounting OCS net income figure from its unitary net income base and argues that such exclusion is required by the OCSLA which forbids State taxation in the OCS, an area outside of any State. However, the inclusion of Shell's OCS activities in the unitary net income base does not, of itself, result in any extraterritorial taxation by Iowa in terms of projecting State sovereignty or political jurisdiction outside the State. Indeed, the record in this case does not show that the Iowa apportioned tax was imposed upon Shell's profits in excess of those earned in Iowa or in disproportion to Shell's Iowa income producing activities. Moreover, separate accounting for an OCS net income figure does not avoid potential duplicative or overlapping State taxation in the OCS since no uniformity in such accounting exists or is required by OCSLA.

The OCS was declared by this Court in 1950 to be an area of paramount federal political jurisdiction. Even without the OCSLA, no State could extend its sovereignty or political jurisdiction there. As a result of this Court's 1950 decisions, the OCSLA was enacted in 1953 to confirm this federal jurisdiction and to define a body of law for

the Federal Government to use in its administration of the OCS. The language of the OCSLA, in 43 U.S.C. § 1333 (a)(2)(A) and in § 1333(a)(3), which forbids State taxation in the OCS, was intended to clarify that States would have no power to exercise political tax jurisdiction in the OCS. The provisions of the OCSLA do not clearly indicate a facial intent to interfere with State apportioned taxes which include OCS activities in a unitary tax base for the purpose of reasonably evaluating the nexus within the taxing State.

The legislative history of the OCSLA reveals a tug of war between proponents and opponents of State taxation in the OCS in terms of whether States should exercise political jurisdiction there. Proponents wanted permission to extraterritorially tax there. Opponents wanted to send clarifying signals in § 1333(a)(2)(A) and § 1333 (a)(3) that precluded such taxation in the OCS. Ultimately, opponents won out. A key sponsor of the OCSLA explained that § 1333(a)(2)(A) and § 1333(a)(3) had the same meaning with respect to State taxation.

The 1953 OCSLA was amended in 1978. These amendments do not change the scope of the 1953 enactment which precluded extraterritorial exercises of State political tax jurisdiction in the OCS. The 1978 amendments do not address State taxation.

The OCSLA does not create a State tax exemption for a nexus off the Shelf related to OCS production. For example, Iowa could impose a gross receipts tax upon Shell's sales in Iowa involving its OCS and non-OCS production which would be more burdensome than the Iowa net income tax. No sound reason exists to construe the OCSLA

to modify honest State efforts that impose a State net income tax as a result of Shell's nexus in Iowa.

Shell's interpretation of the OCSLA under its separate accounting method would result in a penalty, in the form of higher State taxes, for oil producers whose OCS costs and expenses exceeded OCS revenues and a windfall for those, in the form of lower State taxes, if their OCS revenues exceeded their OCS costs and expenses. Oil producers, in particular the smaller multistate producers, who would have to expend huge sums but initially obtain little or no revenue would have a disincentive in the form of higher State income taxes to invest in OCS leases under Shell's interpretation. Iowa's interpretation avoids this anomaly.

The OCSLA should be construed as precluding the exercise of State political jurisdiction in the OCS, thereby codifying Due Process and Commerce Clause limitations upon extraterritorial taxation. The Federal Government agrees with this construction and is not adversely affected thereby. Based upon that construction, Iowa has not violated the OCSLA in this case merely because Shell's OCS activities are included in the unitary net income base which is subject to apportionment.

In the makeup of the unitary net income base, the OCSLA does not require that a distinction be made between Shell's actual sales outside of Iowa that occur on the Shelf and those which occur off the Shelf. Such a distinction, of itself, does not determine whether Iowa exercised political jurisdiction in the OCS. Therefore, the OCSLA does not dictate that actual OCS sales be excluded from the unitary net income base.

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ARGUMENT

THE OUTER CONTINENTAL SHELF LANDS ACT DOES NOT PRECLUDE THE STATE OF IOWA FROM IMPOSING A TAX UPON THAT PORTION OF A UNITARY NET INCOME BASE WHICH IS REASONABLY ATTRIBUTABLE TO THE TAXPAYER'S INCOME PRODUCING ACTIVITIES IN IOWA.

The question of whether a state tax is validly imposed in an area of exclusive federal jurisdiction has often arisen within the context of State attempts to tax property or activities in a federal area within the boundaries of the taxing State.[7] *See e.g. Humble Pipe Line Co. v. Waggonner,* 376 U.S. 369 (1964); *James v. Dravo Contracting Co.,* 302 U.S. 134 (1937); *Surplus Trading Company v. Cook,* 281 U.S. 647 (1930). That, of course, is not the situation here.

In this case, the area of exclusive federal jurisdiction is located outside the borders of any State. The State tax system under attack does not facially purport to impose a tax upon Shell's income producing activities attributable to the OCS. Rather, Iowa is imposing its tax upon Shell's net income "reasonably attributable to" Shell's "trade

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[7]Many cases have involved Art. I, § 8, cl. 17 of the Constitution. That Clause is not involved here. Shell points out that Congress has the power to limit State taxes and demonstrates instances in which this occurs. (Shell Brief at 17-20). Iowa has never taken issue with the authority of Congress to restrict State taxation in the area of the OCS. This case does not involve the question of whether Congress could require States to deduct an OCS net income figure from a unitary net income base, but rather whether Congress has done so. The OCSLA was enacted under authority of Art. IV, § 3, cl. 2 of the Constitution. H.R.Rep. No. 95-590, 95th Cong. 1st Sess. 54 (1977).

or business within the state" of Iowa. Iowa Code § 422.33 (2) (J.S. App. 96a). Shell concedes that it could not prevail upon Due Process and Commerce Clause Constitutional challenges. (Shell Brief at 12). The issue in the case, as Shell states, is "what is to be included in the income base that is subject to apportionment." (Shell Brief at 9, n. 4). The apportionment formula and the makeup of the factors thereof are not an issue.[8] *Id.*

A. Application of the Iowa Unitary Business/Formula Apportionment Method Was Not Shown by Shell to Constitute Extraterritorial Taxation Into the Area of the OCS.

The provisions of the OCSLA which declare that the OCS is an area of exclusive federal jurisdiction and which preclude State tax laws from application in the Shelf, an area located outside the borders of any State, cannot be considered in a vacuum. The division of income of a unitary multistate business associated with activities in the taxing State is inexorably related to a concrete consideration of whether Iowa has violated the OCSLA.

The unitary business/formula apportionment method in the State income tax field is derived from the unit rule of valuation for ad valorem property tax purposes in-

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[8]Apportionment of net income may not be required with respect to a net income tax imposed upon domiciliaries of the taxing State. Domicile can be an independent nexus for State political jurisdiction to impose such tax, regardless where income is earned. *Lawrence v. State Tax Commission,* 286 U.S. 276 (1932).

volving interstate railroads and utilities.[9] I Hellerstein, *State Taxation, Corporate Income and Franchise Taxes* ¶ 8.5 (1983) at 330; Dexter, *The Unitary Concept in State Income Taxation of Multistate-Multinational Business,* 10 Urban Lawyer 181, 184 (1978). If Shell operated an integrated pipeline system, portions of which were in Iowa, in the OCS, and in non-OCS areas, Iowa, in apportioning value to the State, could reasonably consider the entire system in order to determine the enhanced Iowa value rationally related to the Iowa nexus. Such a property tax system would not be imposed upon OCS property in the area of the OCS in violation of the OCSLA merely because the OCS pipeline portion was included in the apportionable unitary property base. Iowa believes that these same principles should apply in evaluating the Iowa income tax imposed upon Shell's income producing activities in Iowa which are not to be valued merely upon the basis of revenues and costs geographically in the State.

The States, in imposing upon multistate unitary businesses a tax upon their net incomes attributable to business activities in the taxing State, had two choices. First, they could select separate accounting which purports "to identify the precise geographical source of a corporation's profits" in the taxing State. *Moorman Manufacturing*

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[9]In *Pullman Co. v. Richardson,* 261 U.S. 330, 338 (1923), this Court noted the rationale for the unit rule of property valuation:

> "And, if the property be part of a system, and have an assigned value by reason of a connected operation of the whole, it may be taxed according to its value as part of the system, although the other parts be outside the state; in other words, the tax may be made to cover the enhanced value which comes to the property in the state through its organic relation to the system."

Co. v. Bair, 437 U.S. 267, 273 (1978). Second, they could use a unitary business/formula apportionment method "employed as a rough approximation of a corporation's income that is reasonably related to the activities conducted within the taxing State." *Moorman,* 437 U.S. at 273.

States were faced with an impossible task of attempting to make a precise allocation of unitary operating income to any geographical source. The very nature of a unitary business meant that its income was not derived from "a single identifiable source."[10] *Mobil Oil Corp. v. Commissioner of Taxes,* 445 U.S. 425, 438 (1980); *Exxon Corp. v. Wisconsin Dept. of Revenue,* 447 U.S. 207, 222 (1980). Separate accounting "is subject to manipulation and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise." *Container Corporation of America v. Franchise Tax Board,* 463 U.S. 159, 164-5 (1983).

Because of these deficiencies in the use of separate accounting, States resorted to formula apportionment to divide the unitary net income base between the taxing State and elsewhere in order to ascertain the value of the income producing activities in the taxing State. Absent a Congressional directive to the contrary, State unitary income/formula apportionment methods need not be uniform. *Container,* 463 U.S. at 167; *Moorman,* 437 U.S. at 280. Because of the inability to precisely allocate a por-

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[10]*See also* discussion in *ASARCO, Inc. v. Idaho State Tax Comm'n,* 458 U.S. 307, 333 (1982) (O'Connor, J., dissenting).

tion of unitary net income to a geographic source, this Court tolerates different State unitary business/formula apportionment methods as long as they do not produce disproportionate amounts of net income subjected to State taxation as a result of instate activities. *Container,* 463 U.S. at 170; *Exxon,* 447 U.S. at 220.

Because separate accounting is flawed, this Court has generally rejected it for components of a unitary business as a benchmark by which to judge whether the State unitary business/formula apportionment method results in extraterritorial taxation in violation of the Due Process and Commerce Clauses. This rejection is in no small part due to the fact that "[a]ccounting practices for income statements may vary considerably according to the problem at hand."[11] *Butler Brothers v. McColgan,* 315 U.S. 501, 507 (1942). Shell's separate accounting which Shell claims is an OCS net income figure should be rejected because "it purports to isolate portions of income received" in the OCS but fails to "account for contributions to income resulting from functional integration, centralization of management, and economies of scale" which constitute

[11]This point is highlighted in the instant case. Shell's separate accounting computation of an OCS net income figure did not attribute any refining or selling expenses to the OCS. Iowa's accountant testified that under generally accepted accounting principles, a portion of such expenses should have been included in the computation. (MDA App. par. 3-4). Obviously, Shell's failure to include a portion of these expenses in its OCS net income figure decreases the remaining unitary net income which Shell concedes that Iowa can apportion. We are not advocating that any form of separate accounting would be appropriate or is required by the OCSLA. We are pointing out that there is no uniform methodology to make a separate accounting of Shell's OCS net income and no way to ensure that the State will not be shortchanged under Shell's interpretation of the OCSLA.

"factors of profitability" that "arise from the operation of the business as a whole." *Mobil Oil,* 445 U.S. at 438; *Exxon,* 447 U.S. at 222. A claim that the Iowa tax constituted extraterritorial taxation into the area of the OCS in violation of Due Process or Commerce Clauses on the grounds that the unitary net income base contained revenues, costs, and expenses located in the OCS would be rejected.[12] *Container Corporation of America v. Franchise Tax Board,* 463 U.S. 159 (1983); *Exxon Corp. v. Wisconsin Dept. of Revenue,* 447 U.S. 207 (1980); *Moorman Manufacturing Co. v. Bair,* 437 U.S. 267 (1978); *Butler Brothers v. McColgan,* 315 U.S. 501 (1942); *Underwood Typewriter Co. v. Chamberlain,* 254 U.S. 113 (1920). These cases demonstrate that the inclusion of revenues, costs, and expenses from outside the taxing State in the unitary net income base does not, of itself, project State sovereignty or political jurisdiction into areas outside the State. Merely because "a tax is contingent upon events brought to pass without a State does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction." *Wisconsin v. J.C. Penney Co.,* 311 U.S. 435, 445 (1940); *Mobil Oil,* 445 U.S. at 437.

Shell's imperfect separate accounting method for a unitary business is inherently incapable of showing its

[12]When the OCSLA was adopted in 1953, this Court had firmly established that States could require multistate enterprises to use a unitary business/formula apportionment method to ascertain taxable results reasonably related to the taxpayer's activities in the taxing state. *Butler Brothers v. McColgon,* 315 U.S. 501 (1942); *Norfolk & Western Ry. v. North Carolina ex rel. Maxwell,* 297 U.S. 682 (1936); *Kent-Coffey Mfg. Co. v. Maxwell,* 291 U.S. 642 (1934), *aff'd per curiam,* 204 N.C. 365, 168 S.E. 397 (1933); *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission,* 266 U.S. 271 (1924); *Underwood Typewriter Co. v. Chamberlain,* 254 U.S. 113 (1920).

OCS net income earned within the area of the OCS. Separate accounting, as a purported estimate of income at a "source," is unable to prevent any possible State duplicative or overlapping taxation within the OCS in that it cannot precisely demonstrate where income is earned and there is no uniform separate accounting method that all States would be required to adopt or even that all taxpayers would advocate.[13] *Container,* 463 U.S. at 190-193. "The prevention of duplicative taxation, therefore, would require uniform rules for the division of income." *Moorman,* 437 U.S. at 279. The OCSLA does not contain such uniform rules, no authority is given to the Secretary of Interior or other Federal official or agency to supply such rules, and no Court could adopt such rules. The OCSLA speaks to State tax restrictions which Iowa believes would be the taxable event or nexus that occurred on the OCS. In this case, the nexus, Shell's income producing activities, occurred in Iowa. Accordingly, Shell's discussion in pages 20-24 of its Brief that Iowa taxed its OCS income misses the mark. Shell's separate accounting method cannot even ensure that it will not grab some of its Iowa profits and shelter them from Iowa taxation.

An examination of Exhibit 7 reveals that for years 1975 through 1980, of the huge amounts of Shell unitary operating income, only a tiny part was apportioned to Iowa. (J.A. 51-56). For example, in 1979, Shell earned $1,076,060,336 of unitary net operating income. (J.A. 55).

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[13]Shell's OCS separate accounting method, "as in Alice in Wonderland, operates in a universe of unreality." I Hellerstein, *State Taxation, Corporate Income and Franchise Taxes* ¶ 8.10 at 368 (1983).

Shell's marketing activities in Iowa resulted in sales of $95,272,787. The apportionment resulted in $5,584,753 of Iowa profits earned as a result of Shell's Iowa trade or business activities.[14]

No tribunal below found that Shell had any OCS net income or the amount thereof. The record in the instant case only supports a finding that the Iowa unitary business/formula apportionment method taxed "only the profits earned within the State." *Underwood Typewriter Co. v. Chamberlain,* 254 U.S. 113, 121 (1920). Shell's separate accounting proof relies "upon the sort of formal geographical accounting whose basic theoretical weaknesses justify resort to formula apportionment in the first place." *Container,* 463 U.S. at 181. There is simply no basis in this case to conclude for the year 1979 that the difference between the Iowa apportioned result of $5,584,753 and the Shell result of $4,868,861, which is $715,892, somehow represents Shell's profits on the OCS which Iowa purports to tax. (J.A. 55). No such conclusions can be made for the other years.

Shell is in no position to argue that the difference, in Exhibit 7, between the Iowa apportioned results and the "Net" column is the OCS net income that Iowa is taxing. (J.A. 51-56). In its Iowa Supreme Court Brief, Shell stated that "[i]t has not been Shell's intent or desire in

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[14]Shell's argument that Iowa inevitably taxed a portion of its OCS net income is fundamentally flawed within the context of the record in this case. "Obviously, all sales are not equally profitable." *Moorman,* 437 U.S. at 276. Shell's Iowa sales may have yielded a much higher amount of Shell's profits than the apportioned profits. *Id.* If so, there would be no basis for any claim that Iowa taxed any OCS income. *Id.*

this case to attempt to prove its Iowa income or lack of income or the amount of OCS income Iowa is taxing." (Shell Iowa Supreme Court Brief at 37). This statement and Shell's Exhibit 7 which purports to show Shell's OCS income subjected to Iowa taxation are inconsistent.

B. The State Tax Prohibitions in the OCSLA Should Be Construed to Only Preclude a State From Exercising Political Jurisdiction in the Area of the OCS.

In *United States v. Louisiana,* 339 U.S. 699 (1950), and in *United States v. Texas,* 339 U.S. 707 (1950), this Court held that the OCS was an area of exclusive federal jurisdiction wherein "the Federal Government enjoyed sovereignty and ownership of the seabed and subsoil of the Outer Continental Shelf to the exclusion of adjacent States."[15] *Gulf Offshore Co. v. Mobil Oil Corp.,* 453 U.S.

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[15]The *Louisiana* and *Texas* cases primarily relied upon *United States v. California,* 332 U.S. 19 (1947), in which this Court decided that "California was not the owner of the marginal belt along its coast beyond the low-water mark, and that the Federal Government had primary rights and power over that belt." *United States v. Louisiana,* 446 U.S. 253, 255-256 (1980). In 1953, Congress enacted the Submerged Lands Act, 43 U.S.C. §§ 1301-1315, which overturned the result reached in *United States v. California,* and "in effect, quit claimed to California whatever interest the Federal Government may have had in, and to, all lands and natural resources lying within three geographical miles seaward of the California coastline." *United States v. California,* 447 U.S. 1, 3 (1980). See *also Maryland v. Louisiana,* 451 U.S. 725, 730 (1981). The Submerged Lands Act disclaimed any intent "to affect in any wise the rights of the United States to the natural resources of that portion of the subsoil and seabed of the Continental Shelf lying seaward and outside of the area of lands beneath navigable waters, as defined in section 1301 of this title, all of which natural resources appertain to the United

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473, 479, n. 7 (1981). These decisions "held that under our constitutional arrangement paramount rights to the lands underlying the marginal sea are an incident to national sovereignty and that their control and disposition in the first instance are the business of the Federal Government rather than the States." *United States v. Maine,* 420 U.S. 515, 522 (1975). The *Louisiana* and *Texas* decisions excluded the States from exercising any political jurisdiction in the area of the OCS.

Given the paramount federal jurisdiction and control over the OCS, there was a pressing need for Congressional action because no body of federal law existed for the Government's administration in the Shelf and for the development of its huge potential resources. H.R.Rep.No. 695, 82d Cong. 1st Sess. 6-7 (1951). The enactment of the OCSLA was "the first attempt by the Congress of the United States to deal with the problems, economic and legal, of the outer Continental Shelf as such." S.Rep.No. 411, 83d Cong. 1st Sess. 5 (1953). "[T]he purpose of the OCSLA was to assert the exclusive jurisdiction and control of the Federal Government of the United States over the seabed and subsoil of the outer Continental Shelf and to provide for the development of its vast mineral resources." *Gulf Offshore,* 453 U.S. at 479. The OCSLA was intended to provide "for the orderly development of

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States, and the jurisdiction and control of which by the United States is hereby confirmed." 43 U.S.C. § 1302. The Submerged Lands Act returned to the States political jurisdiction over submerged lands located within their borders. Wessner, *Outer Continental Shelf Revenue Sharing For Coastal States,* 3 Va. J. Nat. Res. Law 131, 139 (1983).

offshore resources." *United States v. Maine*, 420 U.S. at 527.

1. The Language and Legislative History of the OCSLA Do Not Indicate That Congress Intended to Preclude the Inclusion in the Unitary Net Income Base of OCS Activities for the Purpose of Imposing a State Tax Upon Income Producing Activities in the Taxing State.

The OCSLA clearly confirms that the OCS, which is located beyond the borders of any State, is an area of exclusive federal jurisdiction, and, thus, parallels that confirmation made in 43 U.S.C. § 1302 which was part of the Submerged Lands Act. The OCSLA defines the OCS to be "all submerged lands lying seaward and outside of the area of lands beneath navigable waters as defined in section 1301 of this title, and of which the subsoil and seabed appertain to the United States and are subject to its jurisdiction and control." 43 U.S.C. § 1331(a). By reference to 43 U.S.C. § 1301 in § 1331(a), the OCSLA confirms that the OCS is not within any State boundaries. In 43 U.S.C. § 1332(1), it is stated that "the subsoil and seabed of the outer Continental Shelf appertain to the United States and are subject to its jurisdiction, control, and power of disposition as provided in this subchapter." These assertions of federal jurisdiction in the OCS are further addressed in 43 U.S.C. § 1333(a). These provisions, other than § 1302, confirming exclusive federal jurisdiction in the OCS and declaring it to be an area outside the borders of any State, were in the 1953 OCSLA. Christopher, *The Outer Continental Shelf Lands Act: Key to a New Frontier*, 6 Stan.L.Rev. 23, 61-62 (1953). These provisions, of

themselves, would preclude the exercise of State political jurisdiction in the area of the OCS, including State taxes wherein the purported taxable nexus (property or event) was in the OCS. These provisions would not preclude a State tax imposed as a result of a nexus outside of the OCS and in the taxing State, nor do they purport to do so.

Congress was aware "of the close, longstanding relationship between the Shelf and the adjacent States." *Gulf Offshore*, 453 U.S. at 480, n. 7. "This concern manifested itself primarily in the incorporation of the law of adjacent States to fill gaps in federal law." *Id.* Thus, Section 1333(a)(2)(A) authorizes to the extent that "they are applicable and not inconsistent" with federal law the adoption of "the civil and criminal laws of each adjacent State" to fill voids in federal law as substitute federal law. *Rodrigue v. Aetna Casualty & Surety Co.*, 395 U.S. 352, 357-8 (1969); S.Rep.No. 411 at 15-16; Christopher, *The Outer Continental Shelf Lands Act: Key to a New Frontier*, 6 Stan.L.Rev. 23, 37-43 (1953).[16]

Two provisions in the OCSLA relate to State taxation imposed upon property or events in the OCS and are relied upon by Shell in this case. First, § 1333(a)(2)(A) provides that "State taxation laws shall not apply to the outer Continental Shelf." Second, § 1333(a)(3) provides that "[t]he provisions of this section for adoption of State law as the law of the United States shall never be interpreted as a basis for claiming any interest in or jurisdic-

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[16]Mr. Christopher, in his article, discusses each section of the 1953 Act. *Christopher*, at 31-61. The provisions which follow §§ 1331, 1332, and 1333 were largely concerned with leases in the OCS.

tion on behalf of any State for any purpose over the seabed and subsoil of the outer Continental Shelf, or the property and natural resources thereof." Shell concedes that these provisions clarify that States could not impose taxes in the OCS area. (Shell Brief at 26).

The "State taxation laws shall not apply to the outer Continental Shelf" language appears in a statutory provision which sets forth how the Federal Government, in administration and regulation of the Shelf, is empowered to apply not inconsistent adjacent State law as substitute federal law. One who is unfamiliar with the controversies involving the OCS and the legislative history of the OCSLA might conclude, although erroneously, that Congress only intended that federal officials not apply State taxation laws to the OCS. One may wonder why the language is there because the OCS is located outside the borders of any State. Even if one were to correctly surmise that the provision precluded States from levying taxes in the OCS area, the language does not necessarily suggest that OCS activities not be included in a unitary tax base for the purpose of valuing the local nexus in the taxing State, as was done in the instant case. The statute does not say, as does 31 U.S.C. § 3124 with respect to federal obligations, that OCS activities cannot be considered in the computation of a State tax. The language can mean that State tax laws will not apply to the OCS in a jurisdictional sense.

In *Gulf Offshore Co. v. Mobil Oil Corp.,* 453 U.S. 473, 482 (1981), this Court noted that the language in "Section 1333(a)(3) speaks to the geographical boundaries of state sovereignty, because Congress primarily was concerned in enacting OCSLA to assure federal control over the Shelf

and its resources." Section 1333(a)(3) is a clear expression that no State can exercise "political jurisdiction" in the OCS. *Id.* This Court's view of the language in § 1333 (a)(3) is the same as that of Iowa and supports Iowa's position in this case. Section 1333(a)(3) makes plain that it addresses lack of State political jurisdiction on the Shelf. Indeed, on its face, § 1333(a)(3) purports to clarify that the provisions for federal adoption of adjacent State law as substitute federal law do not give States any political jurisdiction in the OCS. S.Rep.No. 411 at 23.

Since the OCSLA does not clearly prevent apportioned State tax schemes which include OCS activities in the unitary base for the purpose of taxing the taxpayer's activities or property in the taxing State, it is appropriate to engage in construction of the statute and, in doing so, to examine the legislative history associated with the OCSLA. The provisions of § 1333(a), except for the "State taxation laws shall not apply to the outer Continental Shelf" language in § 1333(a)(2)(A), were in the Senate bill, S. 1901. *Rodrique,* 395 U.S. at 357-8; S.Rep.No. 411 at 15-16. The State taxation prohibition language in § 1333(a)(2) (A) was in the House bill, H.R. 5134.

The Senate Committee stated that its "collective judgment" concerning State taxation was that § 1333(a)(3) provided that "state taxation laws necessarily are excluded from applicability in this area of exclusive Federal jurisdiction not inside the boundaries of any state." S.Rep.No. 411 at 3. The floor manager of the Senate bill, Senator Cordon, who had the task of explaining the Conference OCSLA bill to the Senate stated that the language "State taxation laws shall not apply to the outer Conti-

nental Shelf" was "unnecessary" and that "it adds nothing to and took nothing from the bill as it passed the Senate," but that "[i]t was requested in a superabundance of caution and was agreed to by the Senate conferees when offered by the House conferees." 99 Cong. Rec. 10471-10472. This Court has stated that "[i]t is the sponsors that we look to when the meaning of the statutory words is in doubt." *NLRB v. Fruit & Vegetable Packers,* 377 U.S. 58, 66 (1964). Senator Cordon's view that the State tax limitations expressed in § 1333(a)(2)(A) and inherent in § 1333(a)(3) have the same effect was never questioned in the Congressional debates and is a reasonable interpretation. Under that interpretation, a State tax does not contravene the OCSLA as long as it is not an exercise of political jurisdiction in the area of the OCS. *Gulf Offshore,* 453 U.S. at 482. A State tax which does not extraterritorially tax in violation of the Due Process Clause and the Commerce Clause is not the exercise of State political jurisdiction in any area outside the taxing State.

The Congressional debates illuminate the dispute between adjacent State Senators and Congressmen who were proponents of extension of State taxing power in terms of political jurisdiction into the OCS and other Senators and Congressmen who were opponents of that type of State taxation. Proponents sought to justify taxation in the OCS by arguing that OCS production would create burdens upon adjacent States who should be compensated by extraterritorial taxation. 99 Cong. Rec. 2505 (Remarks of Rep. Willis); 99 (Cong. Rec. 4884 (Remarks of Rep. Brooks); 99 Cong. Rec. 7261 (Remarks of Sen. Long). Proponents also attempted to justify

OCS taxation by reference to State taxation with respect to public lands located within the boundaries of the taxing State. 99 Cong. Rec. 2509-2510 (Remarks of Rep. Wilson).

Opponents of State taxation in the OCS area were adamant in opposition to extension of State taxation imposed upon property or events in the OCS. 99 Cong. Rec. 2506 (Remarks of Rep. Celler); 99 Cong. Rec. 2511-2512 (Remarks of Rep. Keating); 99 Cong. Rec. 7234 (Remarks of Sen. Cordon). They argued that it was "unconstitutional" to allow State taxation beyond State borders. 99 Cong. Rec. 2506 (Remarks of Rep. Celler). Even those who professed to have no interest in the subject opposed extension of adjacent State taxing power in terms of political jurisdiction into the OCS area as it was beyond the borders of any State.[17] 99 Cong. Rec. 2515 (Remarks of Rep. Smith); 99 Cong. Rec. 2516 (Remarks of Rep. Jonas).

Senator Long, a proponent of State taxation, believed that taxes upon "present sources of revenue" by adjacent States would have to be increased "if employers of these

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[17]Shell argues that Congressional failure to extend the Mineral Leasing Act of 1920, 30 U.S.C. § 189, and the Buck Act of 1940, 4 U.S.C. §§ 105-110, to the OCSLA indicates that Iowa cannot include OCS activities in the unitary net income base. (Shell Brief at 27). But, these statutes involve Congressional permission to States to levy taxes in federal areas within the borders of States, namely, to exercise State political jurisdiction there. Even without these statutes, there should be no inherent prohibition in including activities in a federal area in a unitary tax base for purposes of valuing a tax nexus outside of the federal area. Opposition to extension of the Mineral Leasing Act, § 189, was because the OCS was located outside of any State. 99 Cong. Rec. 2516 (Remarks of Rep. Smith).

workers are subject neither to the State's severance tax, property tax, nor the tax on corporate profits." S.Rep.No. 411 at 67; 99 Cong. Rec. 7261. Senator Long's remarks appear to be directed to the exercise of political jurisdiction in the OCS area, and not to taxation as a result of activities in the taxing state on an apportioned basis, although he did not clearly express that distinction. In any event, this Court, in the interpretation of the OCSLA, has previously rejected the "fears and doubts" of Senator Long, an opponent of the OCSLA, as any "authoritative guide" in the meaning of §1333(a).[18] *Gulf Offshore Co. v. Mobile Oil Corp.*, 453 U.S. 473, 482-3 (1981).

A study of the Congressional debates with respect to State taxation in the OCS shows that they revolved around whether adjacent States would be given permission to extend their sovereignty to levy taxes in that area. Indeed, Representative Keating, a leading foe of State taxation in the OCS and a supporter of the OCSLA, stated that he would "offer an amendment to provide expressly that this power shall not be vested in the States, and affirmatively that State taxation laws shall not apply in the areas of the outer Continental Shelf." 99 Cong. Rec. 2511.

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[18]Shell relies upon Senator Long's remarks concerning a lack of State power to tax corporate profits. (Shell Brief at 31-32). While Senator Long does not clearly indicate whether he objects to the OCSLA because income producing activities there are not considered to be in Louisiana or whether he objects because he felt that the OCSLA would somehow preclude such activities from inclusion in the unitary net income base, this Court has "often cautioned against the danger, when interpreting a statute, of reliance upon the views of its legislative opponents. In their zeal to defeat a bill, they understandably tend to overstate its reach." *NLRB v. Fruit & Vegetable Packers*, 377 U.S. 58, 66 (1964).

Representative Keating believed that "[n]ow is the time we should say or refuse to say that the abutting States shall have this taxing power." 99 Cong. Rec. 2512. Representative Keating's view that Congress should affirmatively provide that State taxation laws have no application in the OCS was in H.R. 5134. 99 Cong. Rec. 4891.

Congress had extensive debates concerning taxation in the OCS. All were in the context of State exercises of political jurisdiction in the OCS, namely, extraterritorial taxation. Ultimately, Congress agreed with the Attorney General that States should not exercise "extraterritorial jurisdiction" in the area of the OCS. S.Rep. No. 411 at 6.

The debates do not even hint that a legitimate local taxable nexus involving OCS minerals would be affected by the OCSLA. On the contrary, the debates indicate that activities in the taxing State associated with OCS resources were not to be immune from State taxation. 99 Cong. Rec. 7254 (Remarks of Sen. Cordon). Shell's separate accounting application is not supported by these debates.

The language of the OCSLA and its legislative history do not indicate that a State's unitary business/formula apportionment method is to be disrupted by a range of separate accounting techniques which do not even avoid potential duplicate or overlapping State taxation in the OCS. There was no discussion of such disruption in the Committee Reports or during the Congressional debates.

The inclusion of any OCS income in the unitary net income base to ascertain Shell's Iowa taxable profits associated with Shell's Iowa income producing activities

impacts upon Shell's OCS operations in a manner which is so "remote and incidental as to justify a federal court in refusing to relieve a taxpayer from a state tax." *S.R.A. Inc. v. Minnesota,* 327 U.S. 558, 562 (1946). Indeed, the principal beneficiary of the OCSLA, the Federal Government, rejects Shell's sweeping interpretation of the Act and, instead, agrees with Iowa's position in this case.[19] U.S. Brief in No. 86-1593 and U.S. Brief in No. 87-984.

It is, thus, clear from this legislative history that both proponents and opponents of State taxation in the OCS wanted to address that subject in the OCSLA. It is also clear that this legislative history discussed State taxation from the standpoint of the exercise of State legislative power in the OCS. The debates did not demean, nor does the language in the OCSLA, the exercise of State taxing power, as in the instant case, which imposes a tax upon a nexus attributable to activities in the taxing State.

In the construction of the OCSLA, the rule of statutory construction whereby this Court is reluctant to disturb the distribution of powers between the states and the Federal Government is apropos. *United States v. Bass,* 404 U.S. 336, 349 (1971); *Apex Hosiery v. Leader,* 310 U.S. 469, 513 (1940). Taxation is a fundamental and his-

[19]Iowa believes that it is reasonable to conclude that the Solicitor General would have filed a Brief in both the Florida and Iowa Shell appeals herein in opposition to the decisions of the Florida Supreme Court and the Iowa Supreme Court if the Federal Government had concluded that those decisions violated the OCSLA and wrongly interfered with paramount federal interests on the Shelf. Where the United States believed that its OCS interests were adversely affected, it has affirmatively acted. *Maryland v. Louisiana,* 451 U.S. 725 (1981).

torical power of a State with respect to events within State borders even if those events are evaluated in part in light of events occurring outside the taxing State. The assumption that the historic powers of States are only superceded by "the clear and manifest purpose" of Congress is to ensure that the federal-state balance "will not be disturbed unintentionally by Congress or unnecessarily by the Court." *Jones v. Rath Packing Co.,* 430 U.S. 519, 525 (1977). If Congress intended to modify the local tax base in Iowa or provide for a "single source" of unitary income in confirming exclusive federal jurisdiction in the OCS, Congress should have "unmistakenly so ordained," *Commonwealth Edison Co. v. Montana,* 453 U.S. 609, 634 (1981), but did not. Therefore, the OCSLA should not be construed to modify State taxes apportioned to activities in the taxing State.

Shell relies upon 1978 amendments to the OCSLA which were enacted "for modernization of the OCS Lands Act." *Watt v. Energy Action Educational Foundation,* 454 U.S. 151, 154 (1981). (Shell Brief at 37-41). In doing so, Shell cites general policy statements to the effect that the 1978 amendments were intended to assure leases in the OCS for fair market value, secure more funds for the Federal Government, provide incentives for oil producers, and reduce dependence upon foreign oil.[20] Shell does not

[20]Shell does not mention the elaborate process since 1978 involving "four distinct statutory stages to developing an offshore oil well." *Secretary of Interior v. California,* 464 U.S. 312, 337 (1984). In this regard, the 1978 amendments made provisions for affected State input regarding "the size, timing, or location of a proposed lease sale." 43 U.S.C. § 1345(a); *Wesner*

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suggest that these 1978 amendments somehow expanded the scope of State tax limitations which inhere in the 1953 enactment. Therefore, "it is necessary to look beyond general expressions of 'national policy' to specific federal statutes with which the state law is claimed to conflict." *Commonwealth Edison Co. v. Montana,* 453 U.S. 609, 634 (1981).

The goals of the 1978 Amendments listed by Shell are not incompatible with the Iowa apportioned income tax. The tax does not seek to interfere with Shell's ability to obtain a fair return or the Federal Government's ability to do so. It could hardly be argued by Shell, in this case, that the tax is a disincentive for it to produce in the OCS in light of its long-standing presence there and the fact that it does not generally deduct from its unitary net income base an OCS net income figure with respect to tax returns which it files with most other States. (J.A. 47).

Neither the 1953 OCSLA nor the 1978 Amendments purport to exempt taxable events involving OCS resources wherever they may occur off the Shelf. Iowa could levy a property tax upon all tangible property in the State, including OCS oil or products refined from OCS oil. 99

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at 144-145. Shell does not mention that the 1978 Amendments were also intended to balance OCS development with coastal State environmental concerns. H.R. Conf. Rep. No. 95-1474, 95th Cong.2d Sess 4-5 (1978). Iowa does not suggest that the 1978 amendments lessen the force or scope of the State tax restrictions inherent in the 1953 legislation. However, these Amendments, by granting State input into OCS leasing and showing a concern for State environment, hardly suggest a greater State taxation preemption than originally inherent in the 1953 OCSLA. *See* § 1332(3), (4), and (5), § 1346, and § 1351.

Cong. Rec. 7254 (Remarks of Senator Cordon). Iowa could levy a nondiscriminatory gross receipts tax upon Iowa sales, including Shell's sales of products associated with the OCS. The gross receipts tax would be more "burdensome" than the Iowa income tax associated with Shell's Iowa income producing activities evaluated by inclusion of Shell's entire operating income in the unitary net income base. *Moorman,* 437 U.S. at 280. If Iowa levied the gross receipts tax, Shell could not seriously argue that the tax violated the OCSLA. In the instant case, Iowa is levying a net income tax in which Shell's income producing activities in Iowa revolve around its sales of its petroleum products refined from OCS and non-OCS sources. "[I]t would be an exercise in formalism" to say that the Iowa net income tax levied upon Shell's Iowa income producing activities violated the OCSLA when a more burdensome gross receipts tax levied upon Iowa sales did not. *See id.*

In summary, the language and legislative history of the OCSLA, including the 1978 Amendments, do not support Shell's interpretation that it must exclude a purported OCS net income figure from the unitary net income base. Iowa's inclusion of OCS activities in the unitary base for the purpose of valuing Shell's Iowa activities does not, of itself, amount to the exercise of State political jurisdiction on the Shelf. The OCSLA does not require a State tax dilution of a nexus off the OCS. The interpretation of the OCSLA to the effect that it prohibits State taxes which involve the exercise of State political jurisdiction on the Shelf is supported by the language and legislative history of the OCSLA.

2. Shell's Interpretation of the OCSLA Penalizes Oil Producers Whose OCS Related Costs and Expenses Exceed OCS Revenues.

The OCSLA does not contain any standards to determine an OCS net income figure to be removed from the State unitary net income base. The OCSLA has a uniform application throughout the Nation with respect to State tax prohibitions. Where, as is common, the State unitary net income base is tied to federal taxable income, the OCS net income figure ought not to change from one State to another, but there is no mechanism in the OCSLA to preclude such changes in the various States, due to a lack of uniformity among accounting methods, under Shell's interpretation of the OCSLA. Thus, Shell's interpretation of the OCSLA, in effect, allows each State, in complying with the OCSLA, to select from a multitude of separate accounting techniques to ascertain OCS profits—or losses —to be excluded from the unitary net income base.[21]

Shell concedes that "it is possible for Shell's interpretation of the OCSLA to result in *higher* state taxes." (Shell Brief at 10, n. 7). This point highlights the error of Shell's interpretation of the OCSLA. Shell has argued at length that the 1953 OCSLA enactment and the 1978 amendments were intended to preclude inclusion of OCS activities in the unitary net income base because such make-up of the unitary base results in State taxation which allegedly undermines the Federal Government's jurisdiction, control, and regulation in the area of the OCS. (Shell

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[21]Shell, for the year 1978, computed a greater amount of income attributable to Iowa under its method than Iowa did under the Iowa unitary method. (J.A. 54).

Brief at 20-41). Yet, as Shell concedes, the words "State taxation laws shall not apply to the outer Continental Shelf" and the language in the OCSLA which confirms exclusive federal jurisdiction there will, under Shell's theory, if OCS costs and expenses exceed OCS revenues of an OCS producer, result in *higher* State income taxes.

An OCS producer would have to expend time and money before a productive OCS well was developed. In addition, there was always the risk that an OCS lease might be unproductive. Under these circumstances, it does not make sense to construe the 1953 OCSLA, which precludes State tax jurisdiction in the OCS, to cause an increase in the OCS producer's State income taxes as long as OCS costs and expenses exceed OCS revenues. The record in this case confirms the incurring of large expenditures prior to any substantial extraction of OCS resources. (J.A. 23-29). In determining its various State income taxes, the OCS producer, upon excluding these expenditures from its State unitary tax base, may find that it actually owes the State more tax than if it had been allowed to include its OCS activities in the unitary net income base to determine its State taxable income. We fail to see—and Shell has not explained—what 1953 OCSLA policies were served if the States, in 1953, had adopted Shell's interpretation and, as a result, penalized an OSC producer whose OCS costs and expenses "sourced" to the OCS exceeded OCS "sourced" revenues (including actual and imputed "sales") in the form of higher State taxes. Shell's interpretation penalized the smaller multistate producers who wished to expand into the OCS. Congress did not

clearly dictate these results flowing from Shell's interpretation.

Shell agrees that apportioned income taxes were well established in 1953. (Shell Brief at 32-33). Presumably, oil producers were apportioning their unitary net income base, which would have included revenues, costs, and expenses in OCS and in non-OCS areas. These producers would have been shocked to find that their State income taxes were increased because their OCS costs and expenses exceeded their OCS revenues. The Congressional opponents of State taxation in the OCS would hardly approve of such a higher tax result. There is nothing in the 1978 Amendments which indicate approval of such higher State taxes.

The Iowa unitary business/formula apportionment method does not mistreat any oil producer unless that producer can make a showing, lacking here, that the Iowa tax was disproportionate to the taxpayer's Iowa income producing activities. The Iowa method, unlike Shell's method, does not single out an OCS producer for disparate taxation as compared to other taxpayers or even other producers in non-OCS areas.

3. An Interpretation of the OCSLA to Codify Constitutional Due Process and Commerce Clause Restrictions on Extraterritorial Taxation is Reasonable.

The interpretation of a "statute presents a unique problem in which words derive vitality from the aim and nature of the specific legislation." *Federal Trade Commission v. Bunte Brothers, Inc.*, 312 U.S. 349, 351 (1941). The purpose of the OCSLA was to confirm exclusive federal political jurisdiction in the OCS in light of this Court's decisions on the subject and to define a body of law applicable to the federal administration of the OCS and development of its vast resources. This purpose necessarily excluded State political jurisdiction in the Shelf, but merely including OCS activities in a unitary base for the purpose of valuing the local tax nexus does not interfere with federal jurisdiction on the Shelf. The State tax prohibition language in the OCSLA was intended to clarify affirmatively that States could not impose taxes which constitute the exercise of political jurisdiction in the Shelf. The language in the OCSLA is instantly compatible with an interpretation which bans State taxes that would violate Due Process and Commerce Clauses on extraterritorial grounds. The legislative history underscores such Congressional intent.

There are no clear indications that the OCSLA was intended to modify the unitary net income base with concomitant rewards to some taxpayers and penalties to others depending upon whether their OCS revenues were exceeded by their OCS costs and expenses. In light of the nature of an apportioned State net income tax in which receipts, costs, and expenditures may be incurred all over the world and which produce a unitary net income that is not traceable to a single source, Iowa's interpretation of the OCSLA to the effect of codifying Due Process and Commerce Clause restrictions against State extraterritorial taxation is reasonable. The Federal Government, the main beneficiary of the OCSLA, agrees with this interpretation. U.S. Brief at 5-6, filed in No. 86-1593.

Shell's interpretation of the OCSLA would mean that those States which require taxpayers to ascertain

the State net income base by worldwide combined reporting, *Container Corporation of America v. Franchise Tax Board,* 463 U.S. 159 (1983), would have to carve out an island of OCS net income from worldwide unitary net income. An interpretation producing such a result adds nothing to and is not required by the policies underlying the OCSLA.

C. Inclusion in the Unitary Net Income Base of Actual Sales at OCS Wellheads Does Not, by Itself, Determine Whether the State Unitary Business/Formula Apportionment Method Violates the OCSLA.

Given the inadequacy of Shell's separate accounting to avoid possible duplicative or overlapping State taxation, the impossibility of using that accounting to accurately split a unitary business to "source" income to geographical boundaries, and the goal of apportioned taxes to tax income reasonably attributable to the taxing State, the location of Shell's actual sales outside of Iowa, whether on or off the Shelf, is not controlling in the interpretation of the OCSLA.[22]

Contractual provisions between gas producers and pipeline companies differ. *Maryland v. Louisiana,* 451 U.S. 725, 730 (1981). These differences could result in gas sales with OCS wellhead deliveries excluded from the unitary net income base and gas sales with delivery off

[22]In *Shell Oil Co. v. Department of Revenue,* 496 So.2d 789, 790 (1986), appeal pending No. 86-1593, the Florida Court stated that there was a concession that Shell's actual sales on the OCS must be excluded from the unitary net income base to comply with the OCSLA. Iowa never made such a concession and does not agree that it is necessary for OCSLA compliance.

the Shelf included in the base if the OCSLA was interpreted to make sales location on the OCS a sole determinant for purposes of the makeup of the unitary net income base. The OCSLA does not require a State to modify its unitary net income base as a result of these contractual provisions involving sales of gas extracted in the OCS.

In the makeup of the unitary net income base, it is irrelevant whether the third party sales are in Illinois, New York, or in the OCS. The same is true for deductions and expenditures. The locations outside of Iowa of these components of the unitary net income base do not, of themselves, demonstrate that the Iowa unitary business/formula apportionment method did more than even tax "only the profits earned within the State." *Underwood Typewriter Co. v. Chamberlain,* 254 U.S. 113, 121 (1920). Accordingly, the location of the third party gas sales by Shell, whether on or off the Shelf, does not, of itself, determine whether Iowa is exercising political jurisdiction on the Shelf in violation of the OCSLA. Shell's alternative suggestion for exclusion of OCS third party sales from the unitary net income base should be rejected. (Shell Brief at 44-45).

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CONCLUSION

The judgment of the Supreme Court of Iowa should be affirmed.

Respectfully submitted,

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